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EX PARTE OR LATE FILE

BELLSOUTH

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EX PARTE

March 15, 1995

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MAR 15 1995
FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF SECRETARY

Mr. William F. Caton
Acting Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: PR Docket 94-105, Petition of the People of the State of California and the Public Utilities Commission of the State of California to Retain Regulatory Authority Over Intrastate Cellular Service Rates

Dear Mr. Caton:

In accordance with the requirements of Section 1.1200 et seq.of the Commission's Rules, you are hereby notified that on March 15, 1995, Bob Frame, Roy McAllister and David J. Markey, all of BellSouth Corporation, and Gary Epstein, on behalf of BellSouth Corporation, met with Chairman Hundt and Regina Keeney of the FCC to discuss California's Petition to Retain Regulatory Authority Over Intrastate Cellular Service Rates. A copy of the attached materials was presented.

Please associate this notification in the docket referenced above.

If there are any questions in this regard, please contact the undersigned.

Sincerely,

David J. Markey

Attachment

cc: The Honorable Reed E. Hundt
Regina Keeney

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List A B C D E

EX PARTE PRESENTATION
IN THE
CALIFORNIA CMRS PREEMPTION PROCEEDING

(FCC PR DOCKET NO. 94-105)

BELLSOUTH CELLULAR CORP.

MARCH 15, 1995

The California Public Utilities Commission ("CPUC") has failed to meet the burden of proof imposed by the Omnibus Budget Reconciliation Act ("OBRA").

- **OBRA requires the CPUC to demonstrate that market conditions with respect to cellular service fail to protect subscribers adequately from unjust and unreasonable rates or rates that are unjustly or unreasonably discriminatory.**

- **The FCC has correctly determined that OBRA imposes a "heavy burden" on the CPUC to prevail in this proceeding.**

- **Although the CPUC has submitted a large volume of information to the FCC in this proceeding, the information does not support the conclusions advanced by the CPUC and does not satisfy the burden imposed by OBRA.**

The heavy handed regulation of the cellular industry by the CPUC has impeded competition between the carriers.

- **Contrary to the CPUC's assertion to the contrary, the CPUC has rejected outright or delayed the approval of numerous carrier-initiated pro-competitive measures. See Exhibit 1.**

- **The CPUC regulatory scheme provides a substanial disincentive to permanent rate reductions.**

- **Calfornia is the only state in the United States in which the bundling of the sale of cellular service with cellular phones is prohibited.**

- **As the CPUC has relaxed its restrictions, cellular rates have fallen. See Exhibit 2.**

The CPUC's claim that there has been no price competition between the carriers is not supported by the record in this proceeding.

- **The CPUC has criticized the fact that L.A. Cellular's "basic rates" have not changed since L.A. Cellular began operations in 1986.**

- **Only 12% of L.A. Cellular's customers receive service under the "basic rate" plan that has been criticized by the CPUC.**

- **The remainder of L.A. Cellular's customers receive service under alternative rate plans and promotions that provide substantially lower rates to the end users.**

- **Substantial price competition exists between the carriers in the California markets.**

The CPUC's claim that cellular carriers earn supracompetitive returns is unsubstantiated.

- **The rates of return calculated by the CPUC fail to take into account the substantial costs incurred by many carriers in acquiring the FCC authorization to provide cellular service.**

- **The 56% return attributed to L.A. Cellular by the CPUC declines to approximately 18% when the value of the FCC authorization, based on the results of the broadband PCS auctions, is included in the calculation.**

- **The profitability of the cellular systems in the large urban markets reflects the pent-up demand for cellular service and the relative efficiencies of the carriers.**

The CPUC's effort to bolster its petition for continued authority to regulate cellular rates by citing its policy mandating the interconnection of reseller switches is misplaced.

- **The decision which permits resellers to interconnect their switches with the facilities of the licensed carriers provides for "market-based" pricing by the licensed carriers for the services provided to the resellers.**

- **The CPUC's petition for continued authority to regulate cellular rates need not be granted to permit this market-based pricing to continue.**

- **California's reseller switch policies may be preempted by the FCC in the CMRS equal access and interconnection docket.**

- **In any event, the reseller switch policies adopted by the CPUC will not provide any meaningful benefits to the consumers.**

CONCLUSION

The FCC should deny the CPUC's petition for continued authority to regulate the rates of cellular carriers.

The CPUC has failed to demonstrate the need to supercede the federal policy favoring competition with regulation of cellular rates.

The conclusion of the broadband PCS auction heralds the introduction of additional competition in the CMRS marketplace.

EXHIBITS

TO

EX PARTE PRESENTATION

MARCH 15, 1995

EXHIBIT 1

THE CALIFORNIA PUC HAS BEEN PART OF THE PROBLEM, AND NOT PART OF THE SOLUTION. THE CPUC HAS RELAXED ITS RULES ONLY BELATEDLY AND OVER RESELLER OBJECTIONS.

- Advance Notice: All rate reductions required 30 days advance notice prior to 1990, and most required 40 days thereafter.

- Bulk Rates: In 1990, the CPUC raised rates for non-reseller bulk users.

- End User Billing Services: Until 1991, cellular carriers were barred from providing end user bills to affinity groups and other bulk customers.

- Anti-gift Rule: In 1990, the CPUC forbade most usage credits and cash refunds, even where tariffed.

- Anti-bundling Rule: In 1989, the CPUC forbade equipment/service packages.

- Customer-specific Contracts: Cellular companies to this day may not enter into customer-specific contracts without advance CPUC approval.

- New Plans: To this day, new voluntary rate plans may not be introduced without 30 days' advance notice.

Exhibit 1 Additional Details

THE CALIFORNIA PUC HAS BEEN PART OF THE PROBLEM, AND NOT PART OF THE SOLUTION. THE CPUC HAS RELAXED THESE RULES ONLY BELATEDLY AND OVER RESELLER OBJECTIONS.

- Advance Notice Requirements: As early as August, 1989, L.A. Cellular asked for permission to reduce rates on five days' notice, rather than on the required thirty days' notice. The filing was rejected by CPUC Resolution T-14003. Instead the CPUC actually increased the advance notice requirement to 40 days for nearly all filings. D.90-06-025, Finding of Fact 93. It was not until April, 1993 that rates could be lowered (within certain limits) on reduced notice.
- Bulk Rates: In 1990, the CPUC forbade corporations and affinity groups from buying service at wholesale rates. Instead, charges to these customers had to be increased to at least 105% of wholesale levels. D.90-06-025, Ordering Paragraph 18. Then when L.A. Cellular proposed to provide end user billing services at no added charge to bulk accounts, the CPUC enjoined the proposal. L.A. Cellular then sought to tariff its offering. Reseller opposition resulted in sixteen months of delay before L.A. Cellular could implement this badly needed service. Resolutions T-14264, T-14707, and D. 91-06-054.
- Anti-Gift Rule: The rule against cash refunds and other "gifts" was imposed (over carrier objections) by the CPUC in 1990. This rule forced U S WEST Cellular to rescind $300-$400/unit refunds promised to its long-term customers. D.92-02-076 and Resolution T-14607. In 1991, L.A. Cellular attempted to provide $100 gift certificates to new users. The attempt was thwarted by the CPUC's anti-gift rule. Resolution T-14392. To this day cash rebates to cellular users of more than $25 are unlawful in California. D.91-06-054, Ordering Paragraph 16; D.94-04-043, Appendix A at Ordering Paragraph 3.
- Digital Credits: It took L.A. Cellular nine months to obtain CPUC approval to grant digitally capable units service credits of up to $350. D.93-01-014.

- Anti-Bundling Rule: This unique rule against equipment discounts was imposed by the CPUC (over carrier objections) in 1989. D.89-07-019. In July, 1993, the Bakersfield Cellular Telephone Company formally asked California to rescind the rule. More than a year and a half later, i.e., in February, 1995, the CPUC announced its intention to grant the request.
- Customer-Specific Contracts: In February, 1994, L.A. Cellular asked for permission to bid lower rates for the business of large cellular accounts without having to first obtain CPUC approval. The CPUC has not yet acted on this request.

EXHIBIT 2

AS THE CPUC HAS RELAXED ITS RESTRICTIONS, CELLULAR RATES HAVE FALLEN

- There is a direct correlation between CPUC reforms and pro-consumer advice letters. See Chart 1.
- Only 12% of L.A. Cellular units are on the so-called "Basic Plan".
- 88% of units are on lower-priced alternative plans.
- L.A. Cellular revenues/subscriber are 30% less than in 1989.
- L.A. Cellular costs/subscriber are only 3% less than in 1989.
- L.A. Cellular investment/subscriber is only 1.9% less than in 1989.
- Current per minute charges on alternative plans are between 14% and 42% less (at all usage levels) than the nominal rates first set by the CPUC in 1984. See Chart 2.
- Customers may migrate (without any penalty) among alternative plans.

Exhibit 2 Additional Details

AS THE CPUC HAS RELAXED ITS RESTRICTIONS, CELLULAR RATES HAVE FALLEN

- Chart 1 shows that there is a direct correlation between CPUC reforms and pro-consumer advice letters filed by L.A. Cellular. The CPUC has argued that these filings are only temporary -- but this is because of L.A. Cellular's desire to avoid the advance notice requirements that apply to permanent rate changes. In fact, most of the rate reductions and other benefits described in L.A. Cellular's advice letters have been periodically renewed, or allowed to stay in effect to this day.
- L.A. Cellular revenues per subscriber have fallen by 30% in constant dollars since 1989, and 41.7% in inflation- adjusted dollars. CPUC Petition, Appendix H.
- L.A. Cellular operating costs per subscriber have fallen less than revenues, i.e. by 3% in constant dollars and 19.1% in inflation-adjusted dollars. CPUC Petition, Appendix H.
- L.A. Cellular plant investment per subscriber has declined by only 1.9% in constant dollars since 1989. CPUC Petition, Appendix H.
- Only 12% of L.A. Cellular customers are on the so-called basic plan. 88% have migrated to alternative, lower-cost plans.
- According to the CPUC's figures, average rates of return in the three largest California markets were 30.9%, before adjustment for acquisition costs. L.A. Cellular's 1993 rate of return was 20% after adjustment for acquisition costs, and 47.5% without calculating such costs. L.A. Cellular's higher rates of return are due to (a) greater operating efficiencies, (b) conservative depreciation schedules, and (c) extraordinary pent-up demand in the Los Angeles market. Fessler's allegation of a 56.2% average rate of return cannot be supported from L.A. Cellular's records.

- According to the CPUC, average rates of return since 1989 in medium and small markets are 6.76% and (15.7)% respectively prior to adjustment for acquisition costs. CPUC Petition, Appendix F.
- Contrary to CPUC allegations, per minute charges at all levels of use have declined dramatically as a result of migration to alternative plans. See Chart 2. Fessler's allegation of a mere 5.6% decrease ("in real terms") cannot be supported. By the end of 1994, the "basic rates" set in 1984 had lost 49.7% of their value due to inflation. During the same period 88% of L.A. Cellular's customers have migrated to alternative pricing which is from 14% to 42% less (at all usage levels) than basic rates. See Chart 2.
- Contrary to CPUC allegations, alternative plans do not strand customers with unused minutes. There are plans for all levels of usage (see Chart 2), and L.A. Cellular allows customers to migrate without penalty among plans.

CHART 1

LOS ANGELES CELLULAR RATE REDUCTION/CREDIT ADVICE LETTER FILINGS

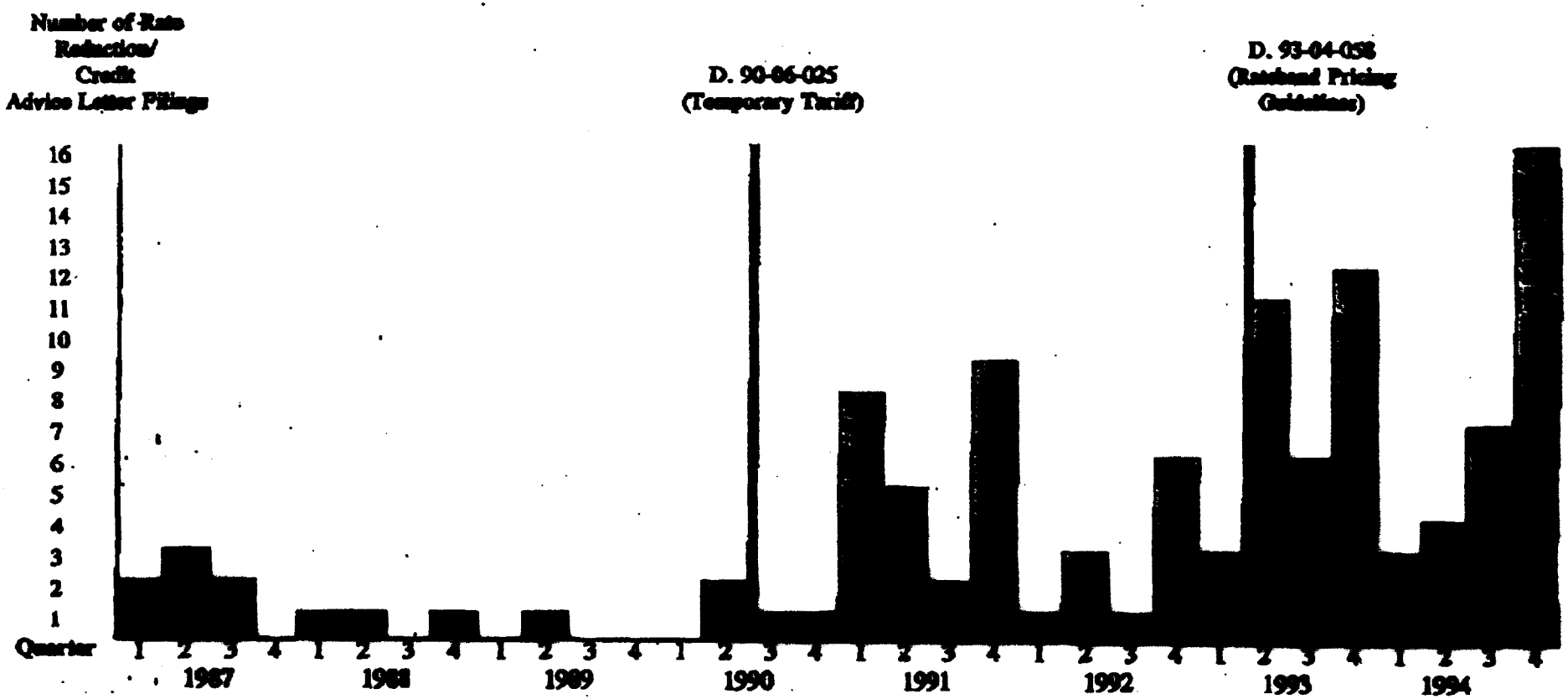

CHART 2

PRICE PER MINUTE ANALYSIS*
(Includes Access and Usage)

	20 min.	50 min.	100 min.	150 min.	200 min.	400 min.
1984 Basic Rate (no contract) (12% of subscribers)	$2.66	$1.31	$.86	$.71	$.63	$.52
Alternatives to Basic Rate (88% of subscribers)						
Analog Units:						
• Corporate/ Affinity Group (no contract)	$2.11	$1.06	$.71	$.59	$.53	$.45
• Corporate/ Affinity Group (contract)	$1.82	$ .92	$.62	$.52	$.47	$.39
• Individual (contract)	$1.75	$1.09	$.77	$.64	$.55	$.44
Digitally Capable Units:						
• Individual (contract)	$1.75	$1.09	$.70	$.59	$.50	$.41
• Corporate/ Affinity Group (contract)	$1.54	$ .79	$.54	$.46	$.41	$.35

* Assumes 75% peak use. Figures are nominal and would be more than 50% lower if restated in 1984 dollars.

K:\D1\1\BBDS\ANALYSIS.DWW

EXHIBIT 3

PUBLIC UTILITIES COMMISSION
STATE OF CALIFORNIA
[redacted]
SAN FRANCISCO, CALIFORNIA [redacted]

DANIEL WM. FESSLER
PRESIDENT

TEL: [redacted]
FAX: [redacted]

March 9, 1995

Via Hand Delivery

Dear

On Wednesday Commissioner Conlon and I met with three members of the Federal Communications Commission to urge them to act favorably on this Commission's petition that it be granted a very limited extension of what has been the traditional role of California in defending consumer interests with respect to wireless phone service. You can thus imagine my anxiety when I discovered that on that very day, the distinguished Chair of the Commission's oversight committee had circulated to colleagues in the Assembly a notice of circulation of a letter to the FCC urging that they deny California's application. I would like to set some facts before you and ask that you consider them before deciding whether you would sign such a letter.

1. **California's petition is fundamentally unlike that of any of the other states which have asked for an extension of authority.** The seven states other than California have sought an extension for an *unlimited*

period of time for *open ended* purposes. If granted by the FCC they may continue into the indefinite future any form of regulation they deem to be in the interest of their citizens. By contrast, California has sought an extension for only eighteen months and only then for a very limited purpose: to introduce competition into what is a grossly uncompetitive market.

2. California citizens, your constituents, suffer some of the very highest cellular rates in the nation. Whatever you may think of attempting to move governmental authority away from the states and localities and put it in the hands of the federal government, it is a fact that these are the very folks who decided to take a public asset, the airwaves, and license them to only two cellular carriers in any given market. In hindsight the expectation that these duopolists would compete with one another looks asinine but that was the federal wisdom. In California we reacted to the promise of this industry in the early 1980's with what may have been excessive enthusiasm. Put bluntly we granted them the highest rates in the nation in the expectation that this would incent the duopolists to rapidly deploy the system. We then went along with the expectation that as they built out the system and added thousands, then hundreds of thousands, and now millions of customers. . .that their rates would come down. This simply has not happened.

California cellular rates were initially set as high as $45 dollars per month to subscribe and 45 cents a minute for use. Those are still the basic rates over ten years later! Compare this to the record of other technology based industries in telecommunications. Think from the perspective of a businessman or woman in California and ask yourself what is the value to cost ratio in purchasing a computer in 1984 vs. 1995? The missing element in the cellular market is competition; the record of high cellular rates in California is caused by lack of competition, not by regulation.[1] I have little doubt that

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[1]The cellular industry attempts to confuse this discussion by employing so-called studies that point to regulation, not the obvious lack of competition, as the cause of high rates. These studies are fraught with serious error, disregard data that do not support their conclusions, misuse economic variables, and assume that certain states with lower rates than California do not regulate cellular services when in fact they do. There is nothing new in these "studies" they were presented to the Senate special hearing on sky high

when genuine competition arrives the cost of these services will finally fall. As an example, in Britain rates fell thirty percent with the advent and deployment of Personal Communications Services. But that competition is not here and it will be several years before it arrives. The issue before you is what to do in the meantime. The industry would prefer business as usual. Do you?

There is one final point on the lack of present competition in California and it bears on another aspect of federal optimism, the FCC has permitted the "competitors" in one market to become *partners* in another. Cellular carriers conveniently forget this when arguing that they are competitors. Did you know that in San Francisco AirTouch and McCaw are partners but these same companies are asked to play the role of competitors in Los Angeles? At a hearing in the Senate one witness spoke for many in the room when he observed that those who anticipate free and genuine competition from this arrangement may well find suspense in the outcome of professional wrestling.

While we are on the subject or rates, be prepared to hear a lot of talk about "discount plans." From the customer's perspective this has been a development with both positive and negative implications. On the plus side, some carriers in some markets have used these plans to offer real savings. I applaud this. On the negative side, most, if not all of these plans, attempt to lock up the customer for one to two years or even longer. The "chill" that this will exert on new market entrants is obvious. It can cost a customer as must as $150 to terminate one of these plans and switch to a competitor when that firm materializes. Here is the bottom line. It is telling that, even though many customers now subscribe to these discount plans, cellular carriers have continued to earn rates of return *in excess of fifty percent* during one of the worst recessions in California history. I believe that you would concur with me in concluding that the high level of subscription to these penalty-heavy plans in certain markets bespeaks more about the unreasonably high basic cellular rates, and nothing about the reasonableness of the discounted rates.

3. The rival explanations for the oppressive cellular rates in California are now history. No matter which version of that history you personally credit, it has nothing to do with the current California

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rates in California. Contact your colleagues to gain their reaction.

petition before the FCC. Please be aware that in the last legislature a hearing was held on the Senate side asking why cellular rates were so high in California. Senators Rosenthal, Russell and Greene all took prominent parts in that hearing. I urge you to read the transcript. Everyone conceded the disagreeable fact that cellular rates in California are among the highest in the nation and that this imposes a competitive disadvantage to every citizen of our state. Disagreement was on the cause. The industry basically argued that this Commission was at primary fault asserting that we forced them to earn huge profits in a non-competitive arena. Pressed by skeptical members of the Senate, they explained that while it was true that the Commission allowed them near complete freedom to lower rates, they pointed to the fact that they would be required to provide a justification to raise those rates back to historic levels. This need to justify a future rate increase was said to be so frightening that they never decreased rates.

Whether you find this proposition credible or not, you need to know that I was willing to act on it. Thus for the past twenty months the industry has had perfect freedom to lower cellular rates on the day they provide us with a simple notice of that fact. They also have perfect freedom to raise rates back to the historic high levels with nothing required other than a same-day notice; these increases are not stayed even if they are protested by cellular resellers. This is the current rate regulation in California. Do you find that unreasonable?

4. Our last effort is to introduce competition in the cellular industry by ordering the duopolists to offer a wholesale rate to resellers which reflects only the services the resellers cannot provide themselves. You may well wonder why California asked to continue authority for only eighteen months? The answer is that we credited the prediction of the cellular carriers that within that time frame they would face real competition from other forms of wireless telecommunication services. We now know that this prediction was grossly optimistic and that the FCC has not even completed the sale of the licenses necessary to allow the major potential competitor to acquire authority to begin the deployment of a rival service. To my mind this development or, more precisely, lack of development makes California's final bid to protect consumers even more important. Let me take a moment to explain it.

As I indicated earlier, it was a federal decision to license only two cellular providers in each market. But the private sector attempted to overcome this governmental stupidity by developing "resellers" who would compete with the duopolists in making retail sales of cellular services to consumers. The problem has been to create circumstances in which the resellers would have something to sell. *If*, as is the current practice, they are forced to buy everything but the element of customer recruiting and billing from the two duopolists then they must rely upon a government imposed "wholesale" rate to have any profit margin as they compete with the duopolists who are also in the retail business! The Commission has attempted to set that rate over time and has been rewarded with very contentious proceedings designed to determine the actual costs to the duopolists in providing the service absent the elements of marketing and billing.

In our view, technology has arrived to rescue consumer interests if only government will permit it to function. To use the term that all industry participants employ, ***the issue is whether we will "unbundle" the duopolists' whole product and allow resellers to utilize their own "switch" when interconnecting to the duopolists' networks.*** It is the resellers' belief that they have devised "switches" (in reality computer programs which seek out access for a caller who is attempting to place or receive a call) that are more modern than those currently used by the duopolists. They contend that if they are not forced to buy a package from the duopolists that includes the switching feature, that they can derive real cost savings which may be as high as twenty percent. They further contend that if this Commission orders the duopolists to offer unbundled options they will pass this savings in part on to consumers in the form of lower rates. Thus we would arrive at a measure of true competition. . .something that could save your constituents money in the next six months.

Faced with our order to unbundle order (which the duopolists do not like) and our petition to the FCC that we be allowed to continue our authority for this brief time to determine if this strategy works, the duopolists have raised a reliability concern. In proceedings here they have expressed fear that a switch designed by a reseller might pose a threat to the stability of the network. We have taken this seriously and have an industry-agreed-upon test connecting a reseller-designed switch to one of the two cellular licensees in Los Angeles which will be completed within ten weeks. If this test reveals